



Office of the City Auditor

Solid Waste Management Reserve Fund Report No. 0505

May 2, 2005

The Solid Waste Management Reserve Fund set out in City Code has not been established. The related Management Fee, while collected, is not recorded as a revenue source to a Reserve. There is no formal structure or planning associated with the use of monies collected that is based on the restrictions set out in the related City Code section. Instead, the Management Fee is viewed as a source for funding Solid Waste operations. As a result, there is no need for the separate City Code section that establishes the Reserve. All needed revenues could be collected under existing Solid Waste service charges.

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May 2, 2005

To the Most Honorable Mary Manross, Mayor
and Members of the Scottsdale City Council

Transmitted herewith is a report on Solid Waste Management Reserve Fund Audit No. 0505. This document sets out a recommendation that is based on conclusions we reached at the close of our survey phase. Both Financial Services and Municipal Services staff were very cooperative during our audit and we would like to thank them for their assistance.

With planned actions to be taken on May 17, issues discussed in this report will be moot. We do believe, however, that it is important to take exception to a portion of management's response (see page 8). Management's position is that the Code requirement for a Reserve Fund was satisfied with the establishment of the Solid Waste Management Fund Reserve currently reflected in budget documents. We respectfully disagree with this conclusion. The FY 92/93 budget book sets out the following definitions:

***Fund** is a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.*

***Reserve** is an account which records a portion of the fund balance which must be segregated for some future use and which is, therefore, not available for further appropriation or expenditure.*

The existing Solid Waste Management Fund Reserve is truly a reserve, a portion of a fund balance that is set aside for meeting the needs of the solid waste enterprise operations. In comparison, the Solid Waste Management Reserve Fund called for in the City Code was intended to segregate restricted revenues that were to be used only for specific activities.

If you need additional information or have any questions, please contact me at 480-312-7756.

Respectfully submitted,

A handwritten signature in dark ink, reading "Cheryl Lee Barcala". The signature is written in a cursive, flowing style.

Cheryl Barcala, CPA, CIA, CFE, CGFM, CISA, CISSP
City Auditor

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EXECUTIVE SUMMARY

An audit of the City's Solid Waste Management Reserve Fund (Reserve) was included on the 2005 Audit Plan for our Office. This Reserve, established in Scottsdale Revised Code (City Code) and funded with a separate fee (Management Fee), is to be used for recycling fees, recycling efforts, compliance with applicable solid waste environmental laws and regulations, source reduction, or other similar activities or programs. The objective of our work was to determine if the funds are collected, tracked, and used in compliance with City Code.

The Reserve set out in City Code has not been established. This means that the Management Fee, while collected, is not recorded as a revenue source to a Reserve. In addition, there is no formal structure or planning associated with the use of monies collected that is based on the restrictions set out in the related City Code section. Instead, the funds collected as a result of the additional Management Fee are considered operating revenue available for use in offsetting the normal costs associated with the collection and disposal of solid waste and recyclable materials. As such, after conducting preliminary interviews and tests to gather information about the volume of revenue generated by the Management Fee and use of the funds, we determined that no additional value could be gained by conducting additional work.

We recommend that management re-consider the need for this Management Fee and submit, for Council approval, a modification to Ordinance to repeal the Solid Waste Management Reserve Fund and the associated funding for it. The impact of this action should then be considered when proposing service fees for the upcoming fiscal year. This treatment would more closely reflect how the revenue is currently used and would eliminate the need to show a separate Management Fee on billing invoices.

The Action Plan on the following page summarizes management's response to that recommendation and the implementation status of management actions. Management's response can be found in Appendix A.

ACTION PLAN

No.	Recommendations and Management Response
1	<p>We recommend that the Financial Services General Manager and the Municipal Services General Manager consider one of the following actions:</p> <p>Submit, for Council approval, the modifications necessary to repeal City Code, Section 24-34, and, if necessary, consolidate the Management Fee into existing solid waste service charges, or;</p> <p>Separately track the collection, use, and fund balance of revenues generated under City Code, Section 24-34.</p>
	<p>Management Response: We concur with the recommendation to submit for Council approval the modifications necessary to repeal City Code Section 24-34, and if necessary, consolidate the solid waste management fee into existing solid waste service charges. A proposal will be made to City Council on May 17, 2005 to consolidate the solid waste management fee with existing solid waste service charges and to delete City Code Section 24-34. Management will continue to review Solid Waste Management enterprise rates on an annual basis and ensure that adequate reserve funds are set aside, per adopted Financial Policies.</p> <p>Responsible Party: Craig Clifford Completed By: May 17, 2005</p>

BACKGROUND

On June 2, 1992, the City Council adopted Ordinance No. 2454, repealing the former chapter of the City Code relating to solid waste and enacting new provisions (Chapter 24, "Solid Waste Management"). Included within this Ordinance is Section 24-34 establishing a Solid Waste Management Reserve Fund and an associated funding source. According to City Code, the Reserve is to be used to fund recycling fees, recycling efforts, compliance with applicable solid waste environmental laws and regulations, source reduction, or other similar activities or programs as deemed necessary in the management and handling of solid waste. The Ordinance set out the following definition:

"Source reduction" means any action which causes a net reduction in the generation of solid waste and includes reducing the use of nonrecyclable materials, replacing disposable materials and products with reusable materials and products, reducing packaging, reducing the amount of yard waste generated, establishing garbage rate structures with incentives to reduce the amount of wastes that generators produce and increasing the efficiency of the use of paper, cardboard, glass, metal, plastic and other materials in the manufacturing process.

To provide funding for the Reserve, the Ordinance incorporates a Management Fee of 25 cents to be charged to all residential and commercial refuse accounts serviced by the City. If those accounts are serviced by more than one container, the Management Fee is to be charged for each container. Commercial refuse generators utilizing City roll-off services are to be charged the 25 cent Management Fee for each disposal (pull) of the roll-off container.

The Utility Billing group within the Customer Service Division bills and collects the Management Fee for residential and commercial accounts along with the monthly service charges set out in Ordinance and a fee mandated by the state. Solid Waste staff sends Utility Billing monthly updates on new accounts or changes in service status including accounts with multiple containers. Utility Billing staff updates their system with the information so that those accounts being provided with solid waste services are charged appropriately.

According to information provided by the Customer Service Director, during FY 03/04 approximately \$228,500 was collected under the solid waste Management Fee. Roll-off container services are billed separately. Roll-off container pulls are tracked by a Solid Waste staff member who provides the information to a member of Accounting for billing. The Management Fee is charged for each "pull." Information provided by Solid Waste staff indicates

that approximately \$560 will be collected during FY 04/05 as a result of this Management Fee.

Both the Solid Waste Director and the Enterprise Finance Director stated that the Management Fee, set out as the funding source for the Solid Waste Management Reserve Fund, is not separately tracked or maintained apart from the revenue generated from the Solid Waste service charges. They each indicated that all revenue streams associated with solid waste and recycling collection services are considered in total when projecting the revenue available to pay for operating expenses. According to information provided by the Solid Waste Director, total recycling expenses for FY 04/05 are budgeted at \$2,282,369. Actual recycling expenses were \$2,077,711 and \$2,203,357 for FY 02/03 and FY03/04 respectively.

SCOPE AND METHODOLOGY

The survey phase of this audit was initiated to gather information about the controls in place to identify the Reserve balance and to limit the use of the fund to the purposes specified in City Code. As part of this process, we reviewed City Code, Section 24-34, to gain an understanding of requirements set out for the Reserve. To obtain an understanding of the underlying rationale for establishment of this City Code section, we obtained the City Council Action Report that adopted the related Ordinance.

We also contacted City staff to discuss procedures, practices, tracking systems, and other tools related to monitoring and using the fund. Specifically, we interviewed the Solid Waste Director and members of his staff, the Customer Service Director, and the Enterprise Finance Director along with one member of his staff.

We performed an analytical test to determine if the amount of revenue collected under the Management Fee was what would be reasonably expected given the number of solid waste accounts being serviced. We obtained the current number of residential and commercial solid waste accounts being billed from the Customer Service Director. We multiplied the reported 74,530 accounts by the monthly \$.25 Management Fee and then multiplied that result by 12 to arrive at an expected annual revenue of approximately \$223,590. We compared our computed estimate of annual revenue to the \$228,543 revenue reported by Customer Service as collected for FY 03/04 and considered the amount of revenue collected to be reasonable based on expectations. We also obtained the first eight months of the Management Fee revenue collected for FY 04/05 and projected the amount to be collected during FY 04/05. This amount (\$232,452) also compared favorably to our expected annual revenue computation. Based on these comparisons and the amount of money involved, we determined that nothing further would be gained by conducting fieldwork on revenue collection.

We could not test the expenditure of funds for compliance, as the Reserve has not been established.

Audit work was conducted in accordance with generally accepted government auditing standards as they relate to expanded scope auditing in a local government environment and as required by Article III, Scottsdale Revised Code, Section 2-117, *et seq.* Survey work began in April and was completed within the same month. Sufficient information was obtained during the survey to conclude that fieldwork was not necessary. Ramon Ramirez conducted the work.

SURVEY PHASE

Finding: Monies collected under City Code, Section 24-34 (c), are not used to fund a Reserve. Instead, they are used as a revenue stream for Solid Waste operations along with other service charges.

Criteria:

Section 24-34 of the City Code is titled, "Solid Waste Management Reserve Fund; Fee" and, in part, provides for the following:

A solid waste management reserve fund is hereby established for the purposes of funding existing and future recycling fees, new and pilot municipal recycling efforts, compliance with applicable solid waste environmental laws and regulations, source reduction or other similar activities or programs as deemed necessary in the management and handling of solid waste.

A monthly solid waste management fee of twenty-five cents (\$0.25) will be charged to all residential and commercial refuse accounts serviced by the city. Residential or commercial accounts that are serviced by more than one (1) container will be charged the solid waste management fee for each container. Commercial refuse generators utilizing city roll-off services will be charged the solid waste management fee for each disposal ("pull") to the roll-off container.

The expectation is that City Code will be followed and, as a result, the above-mentioned Management Fee will be collected as set out and use of the related revenues will be restricted to the identified purposes. This would imply that the revenues would need to be separately tracked to ensure they are used only for intended purposes. To help ensure compliance with this City Code section, we would expect written procedures addressing the collection, tracking, and use of the related revenues.

Condition:

Our analytical tests indicate that the amount of revenue reported as collected under this Management Fee for the current and previous fiscal year appears reasonable given the number of solid waste accounts on record. However, we found that written procedures covering the collection, tracking, or use of the Reserve do not exist. In addition, there is nothing in the City budget book or the CAFR on this reserve even though it is established in City Code. In practice, monies collected under this City Code section are not separately tracked or monitored. To the contrary, these monies are considered an available source for funding Solid Waste operational expenses. However, we determined that the permitted uses of the Reserve are not separate and apart

from the operational services provided by Solid Waste. Specifically, we determined that Solid Waste operations include a recycling program with expenditures that exceeded \$2 million for each of the last two complete fiscal years and which are budgeted to exceed \$2.2 million in the current fiscal year.

While the monies collected under the Reserve are used for operational expenses, we found no specific need for the monies to be collected under the applicable City Code section. They could just as easily be collected under the Solid Waste service charge. City Code, Section 24-34, was established with no sunset provision and as such will continue in existence unless specific action is taken to alter or repeal the Section. Since the funds generated as a result of this City Code section are not set aside into a Reserve but are instead considered a revenue source for Solid Waste's operational needs, there is no functional need for the City Code section to continue in its present form.

Cause:

Management decision.

Effect:

The revenues collected under this City Code provision are not separately tracked or maintained. As a result, a Reserve has not truly been established for the funds. However, the Solid Waste Division does provide the kind of recycling activities called for in City Code, Section 24-34. While the revenues collected under the Reserve are currently relied upon to meet Solid Waste's operational needs, there is no reason why they need to be collected under the auspices of that fund.

Recommendation:

We recommend that the Financial Services General Manager and the Municipal Services General Manager consider one of the following actions:

Submit, for Council approval, the modifications necessary to repeal City Code, Section 24-34, and, if necessary, consolidate the Management Fee into existing solid waste service charges, or;

Separately track the collection, use, and fund balance of revenues generated under City Code, Section 24-34.

APPENDIX A - MANAGEMENT RESPONSE

MEMORANDUM

TO: Cheryl Barcala, City Auditor
Ramon Ramirez, Senior Auditor
FROM: Craig Clifford, Financial Services General Manager
Al Dreska, Municipal Services General Manager
DATE: May 2, 2005
SUBJECT: **Management Response – Solid Waste Management Reserve Fund Audit #0505**

Thank you for the opportunity to comment on the draft audit report No. 0505. Based upon the current draft report, we have prepared the following management response and action plan.

We concur with the auditor's conclusion that there is no need for the separate Code section that establishes the solid waste management reserve fund. We also concur with the recommendation to submit for Council approval the modifications necessary to repeal City Code Section 24-34, and if necessary, consolidate the solid waste management fee into existing solid waste service charges. As recommended, a proposal is agendized for City Council consideration on May 17, 2005 to consolidate the solid waste management fee with existing solid waste service charges and to delete City Code Section 24-34, as part of recommended rate & fee adjustments for the Proposed FY05/06 Budget.

With respect to comments contained in the audit report, there are few clarifications that should be made:

Page 4 & Page 8 audit comments are "The Reserve set out in Code has not been established." Page 9 of the audit report states "there is nothing in the City budget book or the CAFR on this reserve even though it is established in the Code." Since Scottsdale Revised Code Section 24-34 was enacted in 1992, a reserve was established and the City's budget book has consistently included a provision for the Solid Waste Management Fund Reserve, sometimes shown as an "operating reserve". Please refer to the Solid Waste Management Fund Reserve specified on page 26 of the City's Adopted FY 2004/05 Budget, Volume One Budget Summary book. In addition, the designation for Solid Waste Management Reserve is also listed on page 63 of the Comprehensive Annual Financial Report (CAFR) for the year ended June 30, 2004. Since its inception in 1992, this reserve has been revised periodically to more comprehensively provide reserve funding to meet the needs of the Solid Waste enterprise, including recycling efforts, compliance with environmental laws and regulations, source reduction and similar activities deemed necessary in the management and handling of solid waste. The reserve currently provides contingency funding for up to 90 days of budgeted system operating expenditures and is an integral part of the annual rate analysis and financial planning process.

Auditor's Note:

While report content did not change after management review, the page numbering did change in final formatting. As a result, the first three pages referenced in the fourth paragraph above currently correspond to Report page numbers 1, 5, and 6 respectively.